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UNCLAS MADRID 002012

SIPDIS

E.O. 12958: N/A

TAGS: [EFIN](#) [ECON](#) [PTER](#) [ETTC](#) [SP](#)

SUBJECT: SPAIN'S ECONOMY MINISTER LOOKS FOR FISCAL DISCIPLINE AND PRODUCTIVITY, PROMISES SUPPORT ON TERRORISM FINANCE

1. Summary. Second Vice President and Minister of Economy and Finance Pedro Solbes described to Ambassador May 27 his role in the Zapatero government as finding a balance between the "excess enthusiasm" of his fellow ministers and maintaining the fiscal discipline committed to by President Zapatero. Calling the recent model of Spanish economic growth built on domestic demand and construction exhausted, Solbes foreshadowed more government investment in education and research and development to improve Spain's productivity and competitiveness. The Ambassador transmitted the concern he was hearing from the American business community regarding recent statements by members of the Zapatero government which could be interpreted as anti-American, encouraging Solbes to reach out directly to the U.S. business community. Solbes signaled Spain's willingness to continue its close cooperation with the U.S. on terrorism finance, acknowledging the need for urgent passage of implementing regulations for Spain's terrorism finance law and better coordination on designations for terrorist asset freezing. End Summary.

Tone Down the Rhetoric

2. Ambassador opened the May 27 meeting by voicing the concern he was hearing from the U.S. business community over the rhetoric used by the Zapatero government in the runup to the June 13 European Parliament elections. The Ambassador emphasized that for the past five years, the U.S. had been Spain's leading foreign direct investor, bringing in over \$42 billion in FDI. This important constituency was nervous. The Ambassador noted U.S.-Spanish bilateral trade and investment still had much potential and room for growth. The Ambassador encouraged Solbes to reach out, perhaps speaking to the American business groups at a luncheon. Solbes concurred, emphasizing the Zapatero government wanted the best possible cooperation with the U.S., not just in business but across the board.

Fiscal Discipline and the Need for Productivity Growth

3. Emphasizing that he had not participated in the development of the Socialist Party's (PSOE) economic program, Solbes described his job as a balancing act between the "excess enthusiasm" of some of his government colleagues and maintaining the fiscal discipline promised during the campaign by President Zapatero. Solbes lamented the perception that the Aznar government had left everything in the economic sphere in wonderful shape. In reality, there were still many structural reforms to be made. Spanish economic growth in recent years was overly dependent on domestic demand, particularly the construction sector. Spain needed more investment in education and research and development to improve productivity. In response to the Ambassador's query on the vulnerability of the housing sector, Solbes said the government needed to introduce more transparency into housing policy. Solbes noted that Spain spent 40% of GDP on social programs, relatively low compared to some EU countries, but probably still too high. Health care costs amounted to 10% of GDP, but were steadily rising. The Ambassador noted the lack of flexibility of labor markets remained a major problem, Solbes agreed, but observed that it had been a problem for years and slowly but surely was improving. A culture change was needed as well. Judges always sided with the employee seeing him as poor and exploited and the employer as wealthy. Still, Solbes said, compared to France, Germany or Italy, while Spain's standard of living might be somewhat lower, its economy was much more flexible.

Terrorism Finance: A Strong Partner

4. The Ambassador noted our strong desire to continue working closely with Spain in the war against terrorism finance, and thanked Solbes for Spain's leadership in this area. Solbes committed that Spain would continue to be a strong partner on terrorism finance. It would work within the EU framework and encourage greater US-EU cooperation in this area. He understood the importance of swift government approval of implementing regulations for Spain's 2003 terrorist finance law given continued delays and acknowledged traditional attitudes exhibited by some parts of the government slowed our ability to work together on jointly designating and freezing suspect assets.

